87-1248

Supreme Court, U.S.
FILED
JAN 22 1988
JOSEPH F. SPANIOL, JR.
CLERK

No.

In the Supreme Court of the United States

OCTOBER TERM, 1987

UNITED STATES OF AMERICA, PETITIONER

v.

A & B HEATING AND AIR CONDITIONING, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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QUESTION PRESENTED

Whether payments of priority taxes required as a condition of confirmation of the corporate debtor's Chapter 11 plan of reorganization are voluntary payments that the debtor may designate for application first to the trust fund portion of the taxes, thereby relieving the corporation's responsible persons of their separate liability for those taxes.

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v.

A & B HEATING AND AIR CONDITIONING, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-9a) is reported at 823 F.2d 462. The order of the district court (App., *infra*, 13a-15a) is not yet reported. The opinion of the bankruptcy court (App., *infra*, 16a-21a) is reported at 53 Bankr. 54.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 10a-11a) was entered on August 4, 1987. A petition for rehearing was denied on September 10, 1987 (App., *infra*, 12a). On November 27, 1987, Justice O'Connor extended the time for filing a petition for a writ of certiorari to and including January 23, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Section 507 of the Bankruptcy Code, 11 U.S.C. (& Supp. IV) 507, provides in pertinent part:

> Priorities
>
> (a) The following expenses and claims have priority in the following order:
>
> * * * * *
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—
>
> * * * * *
>
> (C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;
>
> * * * * *

Section 1129 of the Bankruptcy Code, 11 U.S.C. (& Supp. IV) 1129, provides in pertinent part:

> Confirmation of plan
>
> (a) The court shall confirm a plan only if all of the following requirements are met:
>
> * * * * *
>
> (9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—
>
> * * * * *
>
> (C) with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of

the plan, equal to the allowed amount of such claim.

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Section 6672 of the Internal Revenue Code, 26 U.S.C. 6672, provides in pertinent part:

> Failure to collect and pay over tax, or attempt to evade or defeat tax
>
> (a) General rule
>
> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

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STATEMENT

1. On February 17, 1984, the Internal Revenue Service (IRS) levied upon and seized certain of respondent's assets to satisfy its assessed and delinquent federal tax liabilities. The assessed taxes consisted of both "trust fund" taxes, *i.e.*, social security and income taxes withheld from the pay of employees and held in trust for the United States pursuant to Section 7501(a) of the Internal Revenue Code (26 U.S.C.), and taxes imposed upon respondent as employer. Respondent thereafter filed a petition for reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C.). The bankruptcy court granted respondent's

emergency complaint for a turnover, ordering the IRS to return the seized property to the bankruptcy estate. App., *infra*, 1a-2a, 14a.

The government filed a proof of claim to collect the taxes in the bankruptcy proceeding, asserting their status as a priority claim.[1] Respondent ultimately proposed a plan of reorganization providing for payment of its priority tax liabilities over a period not to exceed six years, which is a statutory requirement for confirmation of a Chapter 11 reorganization plan (11 U.S.C. (& Supp. IV) 1129(a)(9)(C)). The proposed plan contained a provision stating that all payments to the IRS "shall be credited first to the trust fund portion of the claim until it is paid in full" (App., *infra*, 16a).

The government objected, inter alia, to the feature of the proposed plan that designated how the IRS should apply the priority tax payments. The government argued that payments of priority taxes under a Chapter 11 reorganization plan are involuntary and therefore that the debtor has no right to specify how the payments are to be applied. App., *infra*, 2a. The motivation for the government's objection was the concern that, in the event the taxes were not fully paid under the Chapter 11 plan, the designation would operate to reduce the government's total tax recovery. Under Section 6672 of the Code, corporate officers or other persons who are responsible for remitting withheld taxes to the government are personally liable in the amount of unpaid trust fund taxes that they willfully failed to remit. To the extent the corporation satisfies the outstanding trust fund tax liability first, the responsible

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[1] The taxes involved were entitled at the time to "sixth priority" under 11 U.S.C. 507(a)(6). In the wake of a 1984 amendment that added a new category of priority claims, these federal tax claims are now seventh priority claims. See 11 U.S.C. (Supp. IV) 507(a)(7).

officers' liability is immediately and permanently reduced. See U.S. Dep't of Treasury, *Policy Statement P-5-60, Policies of the Internal Revenue Service Handbook (May 30, 1984), reprinted in* [1 Admin.] Internal Revenue Manual (CCH), 1305-15 (1986). Thus, payment of only the trust fund portion of the tax liability by the corporate debtor would eliminate the responsible officers' potential liability, but still leave the government unable to collect the remaining tax liability. Such a partial payment under the Chapter 11 plan accordingly would not ultimately benefit the public fisc.[2]

2. The bankruptcy court overruled the government's objection (App., *infra*, 16a-21a). The court recognized that the IRS may allocate delinquent tax payments "as it sees fit" when those payments are "involuntary" (*id.* at 17a). Distinguishing on their facts other cases that had held that tax payments made in a judicial proceeding are involuntary, the bankruptcy court held that the Chapter 11 payments are voluntary and thus subject to designation by the corporate debtor. The court stated that, subject to the statutory requirement that the reorganization plan provide for the payment of priority taxes within six years, "[t]he debtor propounding a plan has a number of options with respect to treatment of a claim by the IRS and it is the freedom afforded by these options which dictates the conclusion that payments to the IRS pursuant to a confirmed Chapter 11 plan of reorganization are voluntary" (*id.* at 20a).

The district court affirmed (App., *infra*, 13a-15a). The district court noted that it was "undisputed that the taxpayer's right to direct the application of payments made to the Internal Revenue Service is dependent upon whether

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[2] On the other hand, the designation makes no difference to the corporate debtor (as opposed to its responsible officers) because 11 U.S.C. (& Supp. IV) 1129(a)(9)(C) requires the debtor to pay *all* of its priority taxes, with interest, within six years.

such payments are voluntary" (*id.* at 14a). The court recognized the existence of contrary authority, but concluded that "the better view is that payments made by a debtor pursuant to Chapter 11 reorganization are voluntary" (*id.* at 14a-15a).

3. The court of appeals also rejected the government's position (App., *infra*, 1a-9a). The court first acknowledged the general rule that, "[w]hen * * * a payment is involuntary, the government is free to allocate the payment as it chooses" (*id.* at 2a). The court also quoted the recognized definition of involuntary in this context (*ibid.*, quoting *Amos* v. *Commissioner*, 47 T.C. 65, 69 (1966)): " 'An involuntary payment of Federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor.' " And the court noted that the courts are divided on the question whether tax payments made pursuant to a reorganization plan are voluntary (*id.* at 2a-5a).

The court of appeals regarded the disparity of views on this issue as a "result of the conflicting policies behind the Bankruptcy Code and the Internal Revenue Code" (App., *infra*, 5a (footnote omitted)). The court referred, on the one hand, to the general policy in favor of collection of all taxes due and to the specific policy embodied in Section 6672 of the Internal Revenue Code to impose personal liability on corporate officers who fail to turn over trust fund taxes to the government (App., *infra*, 5a-6a). On the other hand, the court noted the Bankruptcy Code's policy to provide for the rehabilitation of bankrupts and, specifically, the court stated that the Bankruptcy Code has a "preference toward reorganization rather than liquidation" (*id.* at 6a-7a). The court expressed concern that this policy would be undermined if the responsible corporate officers could not use a Chapter 11 designation to shield themselves from Section 6672 liability, because that

would reduce the incentive for the officers to make efforts on behalf of the Chapter 11 reorganization (App., *infra*, 7a). The court therefore concluded (*ibid.*): "In the absence of an express congressional statement that the Internal Revenue Code is to take priority over the Bankruptcy Code with regard to the allocation of tax payments, we decline to accept the argument of the IRS that all payments made under a Chapter 11 reorganization are involuntary and thus properly allocated by the IRS."

The court of appeals held that the designation question should be decided by the bankruptcy court on a case-by-case basis by considering the " 'equitable reasons warranting such allocations.' " App., *infra*, 8a (quoting *In re B & P Enterprises, Inc.*, 67 Bankr. 179, 183 (Bankr. W.D. Tenn. 1986)).[3] The court stated that the most important factor is "whether the proposed plan is merely a stop gap scheme to hold the taxing authority at bay with little chance that the debtor will fulfill its obligation under the plan" (App., *infra*, 8a). Accordingly, the court remanded the case to the district court "with directions that the bankruptcy court weigh the impact the proposed allocation would have upon the debtor, Internal Revenue Service, and other creditors" (*id.* at 8a-9a). The court added (*id.* at 9a): "Should the bankruptcy court conclude that the

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[3] The court of appeals quoted a lengthy list of factors to which, in its view, the bankruptcy court typically should look in making this case-by-case determination (App., *infra*, 8a (quoting *In re B & P Enterprises, Inc.*, 67 Bankr. at 184)):

> the history of the debtor, the absence or existence of prebankruptcy collection or "enforced collection measures" of the I.R.S. against the corporation and responsible corporate officers; the nature and contents of a Chapter 11 plan (e.g., last resort liquidation or reorganization); the presence, extent and nature of administrative and/or court action; the presence of pre- or post-bankruptcy agreements between the debtor (or trustee) and the I.R.S.; and the existence of exceptional or special circumstances or equitable reasons warranting such allocation.

interests of all parties would be best served by allowing the debtor to allocate the payment of taxes, then that determination should stand in the absence of abuse of discretion."

REASONS FOR GRANTING THE PETITION

The court of appeals has erroneously decided an important and frequently recurring question of federal law, in direct conflict with the decision of another court of appeals. The court has held that bankruptcy courts have discretion to allow a corporate debtor's Chapter 11 reorganization plan to contain a provision designating priority federal tax payments under the plan for application first to trust fund tax liability. The decision thus inexplicably holds that payments required by the Bankruptcy Code as a condition of the confirmation of a reorganization plan—and enforceable by the bankruptcy court—may be characterized as "voluntary" in some cases (and "involuntary" in other cases) in the discretion of the court. The effect of the court's holding is to sanction the use of Chapter 11 by corporate officers to eliminate their potential liability for delinquent trust fund taxes and thereby undermine the separate source of collection of those taxes that has been established by Congress. As a result, tax payments under Chapter 11 plans would, as a practical matter, first redound to the benefit of the corporate officers, not the government. If the plan were not successfully completed, the government would still be left with an uncollectible non-trust-fund tax claim, while the corporate officers would have been relieved of their trust fund liability to the extent payments have been made. In light of the frequency with which this issue recurs, it is essential that the conflict in the circuits be resolved and a uniform rule established to guide the conduct of Chapter 11 proceedings.

1. The decision below directly conflicts with the decision of the Third Circuit in *In re Ribs-R-Us, Inc.*, 828 F.2d 199 (1987). In that case, as in this one, the government objected to a proposed Chapter 11 plan that provided that payments of priority taxes were to be applied first to the trust fund portion of the outstanding tax liability. The debtor acknowledged that the validity of such a provision turns on whether the priority tax payments are "voluntary" (see 828 F.2d at 201), and the court of appeals categorically held that such payments made pursuant to a Chapter 11 plan are not voluntary. The court emphasized that the payment of priority tax claims within six years is required by statute (11 U.S.C. (& Supp. IV) 1129(a)(9)(C)) as a condition of the confirmation of a Chapter 11 reorganization plan (828 F.2d at 202-203). The court explained that the obligation to pay the taxes is therefore compelled by a court in the bankruptcy proceeding initiated by the filing of a Chapter 11 petition; "following confirmation, the debtor is subject to an express judicial order in a proceeding concerning the obligation in which both the debtor and the United States are parties" (*id.* at 203). The court further noted that "[t]o interpret payments pursuant to a plan of reorganization as voluntary is inconsistent with the realities of bankruptcy" (*ibid.*). The Third Circuit therefore concluded that "payments of taxes by a debtor undergoing Chapter 11 reorganization are most realistically classified as involuntary for purposes of the debtor's ability to designate to which taxes the payments should be allocated" (*ibid.*). The court added that permitting such a designation would be "in derogation of Congress' strong policy, reflected in section 6672, to protect the government's tax revenues by insuring an additional source from which trust fund taxes can be collected" (*id.* at 204).

The Third Circuit in *Ribs-R-Us* specifically noted the decision of the Eleventh Circuit in this case, and stated that it "respectfully disagree[d]" with it (828 F.2d at 202).

The court explained that "whether a payment of taxes made by a debtor in a Chapter 11 reorganization is to be construed as voluntary for purposes of the debtor's ability to designate to which taxes the payment is to be applied is a question of law rather than an issue for the exercise of discretion" (*ibid.*). And the court also noted the desirability of a uniform rule in these cases so that debtors, creditors, and the government can plan their actions accordingly (*ibid.*).

The Ninth Circuit's recent decision in a slightly different context in *In re Technical Knockout Graphics, Inc.*, 833 F.2d 797 (1987), is also irreconcilable with the decision below. In that case, a debtor that had filed a petition for reorganization under Chapter 11 attempted to designate its tax payments first for application to trust fund taxes, even before the confirmation of its Chapter 11 plan. The court of appeals held that these payments are involuntary and that the bankruptcy court's equitable powers do not permit it to enforce the designation sought by the corporate debtor. The court explained that, once a debtor invokes the protection of the bankruptcy court by filing a Chapter 11 petition, it can no longer claim that its tax payments are voluntary. At that time, "[t]he debtor-in-possession is not free to pay whomever it chooses before the plan is confirmed" (833 F.2d at 803). And, after invoking the assistance of the court to keep its creditors at bay, the debtor "is not free to abuse this system by designating its payments in a way that benefits only its responsible persons, and possibly harms other creditors, including the IRS, without the scrutiny of the court or other creditors" (*ibid.*). The court's reasoning applies with equal or greater force when the payments are made pursuant to a plan of reorganization confirmed by the bankruptcy court, and therefore there can be little doubt that, contrary to the decision below, the Ninth Circuit would not allow a debtor to designate payments made pursuant to a confirmed Chapter 11 plan.

In addition to these court of appeals decisions, the question presented here has been addressed with varying results by numerous lower courts, with appeals currently pending in three courts of appeals.[4] Thus, there exists a clear conflict in the circuits and considerable disarray in the lower courts on an important and persistently recurring issue. It is therefore essential for this Court to resolve the conflict and provide a uniform rule to guide the lower courts in dealing with attempts by Chapter 11 corporate debtors to protect their officers by designating priority tax payments for application first to trust fund tax liability.

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[4] The following cases hold payment of priority taxes in bankruptcy to be involuntary: *In re McCom Communications, Inc.*, 76 Bankr. 180 (N.D. Ala. 1987); *In re Mister Marvins, Inc.*, 48 Bankr. 279 (E.D. Mich. 1984); *In re Frost*, 47 Bankr. 961 (D. Kan. 1985); *In re Avildsen Tools & Machines, Inc.*, 40 Bankr. 253 (N.D. Ill. 1984), aff'd on other grounds, 794 F.2d 1248 (7th Cir. 1986); *In re Vincent-McCall Co.*, 68-2 U.S. Tax Cas. (CCH) ¶ 9591 (E.D. Wis. 1986); *In re Herald*, 66 Bankr. 169 (Bankr. E.D.N.C. 1986); *In re Tam Specialty Co.*, 85-2 U.S. Tax Cas. (CCH) ¶ 9758 (Bankr. N.D. Cal. 1985); *In re State Mechanical, Inc.*, 84-2 U.S. Tax Cas. (CCH) ¶ 9880 (Bankr. W.D. Wash. 1984); *In re Obie Elie Wrecking Co.*, 35 Bankr. 114 (Bankr. N.D. Ohio 1983); *In re Hubler Rentals*, 79-2 U.S. Tax Cas. (CCH) ¶ 9621 (E.D. Pa. 1979). The following decisions hold such payments to be voluntary: *In re Venice Printing Co.*, No. 86-1421 (Bankr. 9th Cir. Apr. 15, 1987), appeal pending, No. 87-6072 (9th Cir.); *DuCharmes & Co.* v. *Michigan*, 75 Bankr. 71 (E.D. Mich. 1987), appeal pending, No. 87-1715 (6th Cir.); *In re Tom LeDuc Enterprises, Inc.*, 47 Bankr. 900 (W.D. Mo. 1984); *In re Professional Technical Services, Inc.*, 78 Bankr. 949 (Bankr. E.D. Mo. 1987); *In re Energy Resources Co.*, 59 Bankr. 702 (Bankr. D. Mass. 1986), aff'd, No. 86-1533 (D. Mass. Aug. 5, 1987), appeal pending, No. 87-1896 (1st Cir.); *In re Lifescape, Inc.*, 54 Bankr. 526 (Bankr. D. Colo. 1985). The following cases hold, like the court of appeals below, that allocation of payments is within the discretion of the bankruptcy court: *Hineline* v. *Household Fin. Corp.*, 72 Bankr. 642 (N.D. Ohio 1987); *In re Vermont Fiberglass, Inc.*, 76 Bankr. 358 (Bankr. D. Vt. 1987); *In re B & P Enterprises, Inc.*, 67 Bankr. 179 (Bankr. W.D. Tenn. 1986).

2. The court of appeals below erred in rejecting the government's contention that the corporate debtor may not include in its Chapter 11 reorganization plan a provision requiring the IRS to apply priority tax payments first to the portion of delinquent taxes attributable to trust fund liability. The IRS has long had a policy of permitting taxpayers to designate the application of tax payments that are voluntarily made. See Rev. Rul. 79-284, 1979-2 C.B. 83, modifying Rev. Rul. 73-305, 1973-2 C.B. 43, superseding Rev. Rul. 58-239, 1958-1 C.B. 94. On the other hand, a taxpayer has no right to designate the application of an involuntary payment, which has traditionally been defined as "any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor" (*Amos* v. *Commissioner*, 47 T.C. 65, 69 (1966)). This policy encourages taxpayers to make voluntary payments. See, *e.g.*, *Muntwyler* v. *United States*, 703 F.2d 1030, 1032 (7th Cir. 1983). In the specific context involved here, this policy encourages responsible officers prior to bankruptcy to resist the temptation to borrow money from the government's trust fund, *i.e.*, to use taxes that have been withheld from employees' wages to pay other business expenses; instead they are motivated to turn those withheld funds over to the government in a timely fashion. Such voluntary compliance with the trust fund structure avoids the expenditure of government resources on collection by means of administrative levy or judicial proceedings, which, of course, would be involuntary collection that would not permit the taxpayer to make a designation. See, *e.g.*, *In re Ribs-R-Us, Inc.*, 828 F.2d at 201-202; *In re Avildsen Tools & Machines, Inc.*, 794 F.2d 1248, 1251 (7th Cir. 1986).

As the Third Circuit concluded in *Ribs-R-Us*, the statutory scheme governing reorganization proceedings compels the conclusion that priority tax payments under a

Chapter 11 reorganization plan are not voluntary, and therefore, under the universally recognized principles summarized above, the debtor cannot direct the IRS how to apply those payments. A Chapter 11 debtor is specifically required by statute to pay all of its priority taxes as a condition of confirmation of its reorganization plan (11 U.S.C. (& Supp. IV) 1129(a)(9)(C)). Once the bankruptcy court confirms the plan, it has the power to compel compliance (11 U.S.C. (& Supp. IV) 105(a), 1112(b), 1142(b)). Thus, while the corporate debtor may have some "latitude" (App., *infra*, 20a) in some of the details of how it structures its repayment plan, it cannot reorganize its business at all unless it undertakes to pay priority taxes in full within six years. In short, once a debtor decides to avail itself of the protections of Chapter 11, it has no choice but to pay its priority tax obligations; a characterization of such payments as "voluntary" simply cannot be squared with the statutory limitations.

Moreover, as the court below recognized (see App., *infra*, 5a-6a), permitting a corporate debtor to designate its priority tax payments would seriously undermine the strong congressional policy to assure collection of trust fund taxes. Taxes that are withheld by an employer from his employee's wages are credited by the government to that employee's account as paid, whether or not the withheld funds are actually paid over to the government by the employer; accordingly, the loss from the employer's failure to turn over these trust fund taxes is suffered directly by the Treasury. See 26 U.S.C. 31(a); *Slodov* v. *United States*, 436 U.S. 238, 243 (1978). To prevent such losses, Section 6672 of the Internal Revenue Code provides that the government may collect the amount of delinquent withholding taxes from the persons responsible for not turning them over to the government. This provision establishes both an alternative means of collection and a strong disincentive to corporate officers to draw upon

withheld taxes to alleviate a corporation's financial difficulties.

The decision below, however, allows corporate officers to use Chapter 11 proceedings as a shield to protect themselves from Section 6672; as the court below acknowledged (App., *infra*, 4a), the designation sought here "solely benefits the responsible officers of the corporation [by reducing their Section 6672 liability] without benefitting the corporation or Internal Revenue Service." Corporate tax payments that would otherwise be applied to reduce the corporation's other tax liabilities for which there is no alternative means of collection will instead be applied to reduce the potential exposure of the corporate officers for the delinquent trust fund liability. Thus, in the event that the delinquent taxes are only partially paid the Treasury will still suffer a loss, while the corporate officers responsible for the failure to pay over the trust fund taxes will escape liability to the extent the trust fund delinquency has been reduced. Most importantly, the knowledge that such a designation eventually will be available in Chapter 11 proceedings may well operate to eliminate the disincentive for corporate officers to use the trust fund to try to alleviate the corporation's pre-bankruptcy financial difficulties. The specter of Section 6672 liability is removed as a deterrent to the conversion of trust funds if the responsible officers believe that they can ultimately escape liability under cover of Chapter 11 if the corporation's financial difficulties prove insurmountable.

The court of appeals clearly erred in holding that the principles underlying Section 6672 must be subordinated in this context because of a supposed conflict with the general policies of the Bankruptcy Code to rehabilitate debtors. There is no basis for believing that Congress created any such conflict. To the contrary, Congress has recognized that failing corporations often intentionally amass large tax debts, rather than becoming indebted to

other creditors, because "detection of nonpayment is more difficult for the taxing authority than it is for a supplier or lender, and * * * an unpaid taxing authority is usually unable to take collection action for months" (H.R. Rep. 95-595, 95th Cong., 1st Sess. 193 (1977)). See also *United States* v. *Sotelo*, 436 U.S. 268, 277 n.10 (1978). For this reason, the rules governing bankruptcy proceedings are designed to facilitate the full payment of tax liabilities. As we have noted, withholding and certain other tax liabilities are accorded priority status in bankruptcy proceedings (11 U.S.C. (Supp. IV) 507(a)(7)), and the plan of reorganization must provide that those taxes will be paid in full.

With respect to the particular type of liability involved here, the bankruptcy system is specifically designed to preserve the availability of Section 6672's alternative method of collecting delinquent trust fund taxes. When a responsible person files for personal bankruptcy, his Section 6672 liability is also a priority claim (11 U.S.C. (Supp. IV) 507(a)(7)(C)), and that liability is not dischargeable and hence remains collectible after bankruptcy (11 U.S.C. (& Supp. IV) 523(a)(1)(A)). Thus, there is no basis for believing that Congress intended to sacrifice in any way the collection of unpaid withholding taxes in order to accommodate reorganizations by bankrupt debtors.[5]

In addition, the court of appeals erred as a practical matter in finding that allowance of the debtor's proposed

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[5] Indeed, trust fund taxes that have not been paid over to the government prior to bankruptcy, but are still in the debtor's possession, are not even included in the property of the estate that is available to be used in the reorganization. Rather, such funds are viewed as property in which the debtor holds "only legal title and not an equitable interest," which is excluded from the bankruptcy estate (11 U.S.C. (& Supp. IV) 541(d)). See 124 Cong. Rec. 32417, 34016-34017 (1978).

designation would advance the goal of achieving a successful reorganization. The concern expressed by the court of appeals was that corporate officers, whose best efforts are critical to a successful reorganization, will lose their incentive to continue with a corporate reorganization if they know that they will still be pressured to pay the delinquent trust fund taxes out of their own pockets (App., *infra*, 7a). This conclusion is quite mistaken. Permitting the designation sought by the corporate debtor here would not necessarily alleviate the officers' concern over personal liability. A designation by itself does not prevent the IRS from collecting the unpaid balance of trust fund taxes from a responsible person.[6] What it does is require that payments actually made by the corporate debtor be applied to reduce the outstanding trust fund liability and hence the potential liability of responsible officers. Thus, if designations like that proposed here are approved, it would be in the interest of the IRS to commence immediately efforts to collect the trust fund taxes from the responsible officers before the outstanding liability is reduced by the corporate funds being paid under the reorganization. By contrast, if, as we contend, the IRS is

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[6] The courts have uniformly held that, when a corporation files for bankruptcy, the bankruptcy court cannot enjoin the IRS from collecting the Section 6672 liabilities of its corporate officers. See *In re LaSalle Rolling Mills, Inc.*, 832 F.2d 390 (7th Cir. 1987); *A to Z Welding & Mfg. Co.* v. *United States*, 803 F.2d 932 (8th Cir. 1986); *United States* v. *Huckabee Auto Co.*, 783 F.2d 1546 (11th Cir. 1986). A different rule would allow the responsible officers to have the best of both worlds. They could essentially obtain the benefit of the automatic stay that is accorded to a bankrupt debtor without actually filing for bankruptcy and thus taking the steps that Congress deemed necessary to assure the ultimate collection of the Section 6672 liabilities, namely, surrendering one's assets for administration as part of the bankruptcy estate in a proceeding in which Section 6672 liability is a nondischargeable, priority claim.

entitled to apply those Chapter 11 payments as it sees fit, this incentive to rush to institute collection actions against the responsible officers is removed; instead, if the statute of limitations does not present a problem, the IRS can await the outcome of the reorganization, which, of course, will satisfy the trust fund tax delinquency and eliminate the responsible officers' potential liability if it is successful.

Finally, the court of appeals seriously erred in holding that the validity of a corporate debtor's designation should be determined on a case-by-case basis in the discretion of the bankruptcy court. As the Third Circuit stated in *Ribs-R-Us*, whether a corporate debtor is permitted to include a designation provision in its Chapter 11 reorganization plan "is a question of law rather than an issue for the exercise of discretion" (828 F.2d at 202). Surely, whether a priority tax payment under a Chapter 11 plan is "voluntary" or "involuntary," which the court below recognized as the controlling inquiry (App., *infra*, 2a, 7a), cannot vary from case to case depending on a discretionary analysis of a vague list of "equitable" factors (see note 3, *supra*). The bankruptcy courts do not have "a roving commission to do equity" (*United States* v. *Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986)); their "equitable powers may only be exercised in a manner which is consistent with the provisions of the Code" (*Johnson* v. *First Nat'l Bank*, 719 F.2d 270, 273 (8th Cir. 1983), cert. denied, 465 U.S. 1012 (1984)). No provision of the Bankruptcy Code authorizes the bankruptcy courts to make decisions based on equitable factors concerning the manner in which the Internal Revenue Service should apply payments of priority taxes; indeed, the exercise of such power "would subvert the Bankruptcy Code" to the extent the Code protects the government's ability to collect Section 6672 liability (*In re Technical Knockout Graphics, Inc.*, 833 F.2d at 803). Rather, the validity of a debtor's designation of how to

apply such payments is a question of law to which there should be one answer applicable to all Chapter 11 cases.

3. Resolution of the question presented here is of considerable importance to the administration of the tax laws. As we have noted (see note 4, *supra*), the issue of the validity of a corporate designation in a Chapter 11 plan is one that frequently recurs because most corporate bankruptcies involve withholding tax liability, and the lower courts are in considerable disarray on this issue. Thus, resolution of the conflict will eliminate disparate results among taxpayers depending upon the jurisdiction in which they file their Chapter 11 petition and will provide a uniform rule upon which debtors and creditors can rely in planning. Moreover, the issue has a significant fiscal impact upon the government. When a Chapter 11 reorganization fails after a few payments are made, as most of them do,[7] the effect of the designation is to reduce the amount of the outstanding tax liability that is collected by the government because of the reduction in the responsible officers' preexisting Section 6672 liability.[8] Allowing such a designation thus shifts the risk of failure of the plan from the responsible officers, whose improper conduct created the delinquency in the first place, to the government. At all events, resolution by this Court of the con-

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[7] The Administrative Office of the United States Courts has estimated that 90% of Chapter 11 reorganization plans fail. See *In re Timbers of Inwood Forest Assocs., Ltd.*, 808 F.2d 363, 382 (5th Cir. 1987) (Jones, J., dissenting), aff'd, No. 86-1602 (Jan. 20, 1988). The court of appeals in this case itself appears to have recognized the high likelihood of failure in that it directed the bankruptcy court on remand to consider whether that reorganization plan was merely a "stop gap scheme to hold the taxing authority at bay," notwithstanding the fact that the bankruptcy court had already "passed on the feasibility of the plan" (App., *infra*, 8a).

[8] The Collection Division of the IRS estimates that up to $25 million per year in tax revenue could be lost if designations are permitted routinely.

flict in the courts of appeals is required if there is to be even-handed administration of the tax and bankruptcy laws.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JANUARY 1988

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

No. 86-3440

IN THE MATTER OF A & B HEATING & AIR CONDITIONING, DEBTOR

UNITED STATES OF AMERICA, PLAINTIFF-APPELLANT

v.

A & B HEATING & AIR CONDITIONING, INC., DEFENDANT-APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA

Aug. 4, 1987

Before: HILL and HATCHETT, Circuit Judges, and HENDERSON, Senior Circuit Judge.

HILL, Circuit Judge:

On February 17, 1984, the Internal Revenue Service levied upon the assets of A & B Heating & Air Conditioning, Inc. for failure to pay withheld trust fund taxes[1] and

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[1] "Trust fund" taxes consist of social security and federal income taxes withheld by an employer from the wages of the employees. *See* 26 U.S.C. § 3102 (1982) (placing duty of collection upon employer). These funds are to be held in a special trust for the United States. 26 U.S.C. § 7501 (1982). The Internal Revenue Code imposes personal liability on responsible corporate officers who fail to remit these funds to the government. 26 U.S.C. §6672 (1982).

other delinquent taxes. Ten days later, A & B Heating filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. The proposed bankruptcy plan provided for the payment of the debtor's federal tax liability over a period not to exceed six years, with the first payments being allocated towards the trust fund taxes. By paying off the trust fund taxes, the corporate president and sole shareholder would be relieved of his separate liability under 26 U.S.C. § 6672 (1982) for these trust fund taxes. The government objected to the debtor's reorganization plan, arguing that the debtor had no right to allocate its payment of taxes. The bankruptcy court overruled the government's objection to the plan. The district court affirmed.

As a general rule, when a taxpayer directs the manner in which a payment is to be allocated among various taxes due, the Internal Revenue Service must comply with the taxpayer's request. *Wood v. United States*, 808 F.2d 411, 416 (5th Cir.1987). When, however, a payment is involuntary, the government is free to allocate the payment as it chooses. *Muntwyler v. United States*, 703 F.2d 1030, 1032 (7th Cir.1983). The definition of involuntary payments is set forth in *Amos v. Commissioner*, 47 T.C. 65, 69 (1966): "An involuntary payment of federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor." The courts are equally divided as to whether tax payments made pursuant to a bankruptcy plan are voluntary.[2]

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[2] Ten courts have found tax payments made pursuant to a bankruptcy plan to be involuntary. *In re Frost*, 47 B.R. 961 (D.Kan.1985); *In re Mister Marvins, Inc.*, 48 B.R. 279 (E.D.Mich.1984); *Avildsen v. United States, (In re Avildsen)*, 40 B.R. 253 (N.D.Ill.1984), *aff'd*, 794 F.2d 1248 (7th Cir.1986); *In re Herald*, 66 B.R. 169 (Bankr.E.D.N.C.1986); *In re Tam Specialty Co.*, 57 Br.

The rationale of the courts which have found payments in bankruptcy to be involuntary was succinctly summarized in *In re Frost*, 47 B.R. 961, 965 (D.Kan.1985) (payments under Chapter 13 held involuntary):

> In order to determine whether a payment to the IRS is voluntary or involuntary, it must be determined whether or not the payment was received through court or administrative action which resulted in an actual seizure of the property or money. The instant bankruptcy proceeding filed by the debtors is a legal action in which the IRS has filed a claim for delinquent taxes. The payments to be made by the debtors are under the bankruptcy court's jurisdiction and are made pursuant to a plan which must comply with the requirements of the bankruptcy code. Thus, we conclude that payments made by the debtors to the IRS are not voluntary and the IRS has the right to allocate the payments as it sees fit.

The Seventh Circuit in dicta expressed a similar sentiment. *See Muntwyler v. United States*, 703 F.2d 1030,

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37 (Bankr.N.D.Cal.1985); *In re Office Dynamics, Inc.*, 39 B.R. 760 (Bankr.N.D.Ga.1984); *In re Obie Elie Wrecking Co.*, 35 B.R. 114 (Bankr.N.D.Ohio 1983); *Hannan Trucking, Inc. v. United States (In re Hannan Trucking, Inc.)*, 17 B.R. 475 (Bankr.N.D.Tex.1981); *Hubler v. Gutman (In re Hubler Rentals, Inc.)*, 79-2 U.S.Tax Cas. (CCH) ¶ 9621 (Bankr.E.D.Pa.1979); *In re Vincent-McCall Co.*, 68-2 U.S.Tax.Cas. (CCH) ¶ 9591 (Bankr.E.D.Wis.1968). Six decisions have found payments made pursuant to a Chapter 11 reorganization to be voluntary. *Tom LeDuc Enter. v. United States (In re Tom LeDuc Enter.)*, 47 B.R. 900 (W.D.Mo.1984); *In re Energy Resources Co.*, 59 B.R. 702 (Bankr.D.Mass.1986); *Hineline v. Household Finance Corp. (In re Hineline)*, 57 B.R. 248 (Bankr.W.D. Ohio 1986); *In re Lifescape, Inc.*, 54 B.R. 526 (Bankr.D.Colo.1985); *In re Franklin Press, Inc.* 52 B.R.151 (Bankr.S.D.Fla.1985); *In re Hartley Plumbing Co.*, 32 B.R. 8 (Bankr.M.D.Ala.1983).

1034 n. 2 (7th Cir.1983). In *Avildsen v. United States (In re Avildsen)*, 40 B.R. 253, 256 (N.D.Ill. 1984), the court found such reasoning to be equally applicable to all bankruptcy proceedings: "[T]he fact that this case deals with a reorganization rather than a liquidating bankruptcy does not change the involuntary nature of the payments." Additionally, the government's position is strengthened by the argument that allowing the debtor to allocate the payment of taxes solely benefits the responsible officers of the corporation without benefitting the corporation or Internal Revenue Service. Accordingly, a strong argument is made that the separate liability imposed under 26 U.S.C. § 6672 (1982) should remain upon the heads of the corporate officers whose actions, or inaction, resulted in the dissipation of the trust fund taxes. *In re Tam Specialty Co.*, 57 B.R. 37 (Bankr. N.D.Cal.1985).

Equally strong precedent can be found supporting the argument that payments in bankruptcy, particularly in the context of a non-liquidating Chapter 11 proceeding, constitute voluntary payments. The bankruptcy court's decision in this case points to several aspects of the Chapter 11 proceeding which allow the debtor great latitude in making tax payments:

> Court involvement in the context of a Chapter 11 reorganization case is not the type which results in seizure of property or money as in a levy. Unlike a taxpayer faced with a government instituted collection proceeding which may lead ultimately to levy upon the taxpayer's assets, a Chapter 11 debtor enjoys great latitude in how and if a plan is proposed and thus how and when the IRS will be paid. § 1129 requires only that a plan provide for payment of prepetition taxes over a period not to exceed 6 years from the date of assessment in order that it may be confirmed. The debtor propounding a plan has a number of options with respect to treatment of a claim by the

> IRS and it is the freedom afforded by these options which dictates the conclusion that payments to the IRS pursuant to a confirmed Chapter 11 plan of reorganization are voluntary.

In re A & B Heating & Air Conditioning, 53 B.R. 54, 57 (Bankr.M.D.Fla.1985), *aff'd*, No. 85-1552-Civ-T-13 (M.D.Fla. May 7, 1986). Similarly, the United States Bankruptcy Court for the District of Colorado has concluded: "The fact that payments are made pursuant to a plan which must comply with the requirements of the Bankruptcy Code does not rise to a level of court action equivalent to a levy, judicial order, execution or judicial sale." *In re Lifescape, Inc.*, 54 B.R. 526, 529 (Bankr.D.Colo.1985) (Chapter 11).

These contradictory court holdings are a direct result of the conflicting policies behind the Bankruptcy Code and Internal Revenue Code.[3] On the one hand, Congress, by enacting 26 U.S.C. § 6672 (1982) intended to impose liability upon corporate officers who allow trust fund

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[3] The conflicting goals of tax collection and rehabilitation of bankruptcy entities was specifically recognized by Congress in drafting the Bankruptcy Code:

> In a broad sense, the goals of rehabilitating debtors and giving equal treatment to private voluntary creditors must be balanced with the interests of governmental tax authorities who, if unpaid taxes exist, are also creditors in the proceeding.
>
> . . . .
>
> A three-way tension thus exists among (1) general creditors, who should not have the funds available for payment of debts exhausted by an excessive accumulation of taxes for past years; (2) the debtor, whose "fresh start" should likewise not be burdened with such an accumulation; and (3) the tax collector, who should not lose taxes which he has not had reasonable time to collect or which the law has restrained him from collecting.

S.Rep. No. 989, 95th Cong., 2d Sess. 13-14, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5799-800.

taxes to be used for any purpose other than the payment of withheld taxes:

> The laws of the United States require all employers to withhold from their employees' gross wages a scheduled amount representing the employees' FICA and income tax obligations. As to the amount representing income tax withholdings, the Internal Revenue Code states that these amounts "shall be held to be a special fund in trust for the United States." 26 U.S.C. § 7501 (1982). If the employer violates this fiduciary obligation and misappropriates these withholding funds (even if in a purported good faith effort to keep the business afloat), the United States must nevertheless extend a credit to the employees as if the funds were properly paid over to the government. . . . Because the government bears the loss caused by an employer's defalcation, Congress has provided the government with several remedies, one of which lies against the individual personally responsible for the misappropriated funds. [26 U.S.C. § 6672 (1982)] was intended to "cut through the shield of organizational form" and impose liability upon those individual persons actually responsible for an employer's failure to withhold and pay over the taxes.

United States v. Huckabee Auto Co., 46 B.R. 741, 743 (M.D.Ga.1985) (citations omitted), *aff'd*, 783 F.2d 1546 (11th Cir.1986). Furthermore, we have consistently recognized that the Internal Revenue Service is charged with the responsibility to collect all taxes due. Public policy dictates that the Internal Revenue Code be interpreted in such a manner as to maximize the public fisc.

On the other hand, Congress has enacted a detailed Bankruptcy Code which sets forth an orderly process by which creditors of a bankrupt entity are to be repaid. In doing so, Congress "has provided bankrupts with extensive protection from their creditors and a reasonable

opportunity to rehabilitate not only for their benefit but for that of the public as well." *In re Energy Resources Co.*, 59 B.R. 702, 706 (Bankr.D.Mass.1986). The Code expresses a preference toward reorganization rather than liquidation; a viable reorganization plan typically provides greater payment to creditors while preserving the economic life of the entity. Permitting the Internal Revenue Service to allocate tax payments in all Chapter 11 proceedings runs contrary to this policy. In numerous Chapter 11 reorganizations, the failure to allow the debtor to allocate tax payments is detrimental to the reorganization plan:

> If corporate officers are pressured to pay the taxes out of their own pockets, the incentive to continue successful reorganization is reduced, and it becomes more likely that the responsible officers will convert to Chapter 7 liquidation. Under Chapter 7, as in Chapter 11, taxes have priority; the government will be paid in full whether sufficient funds remain for other unsecured creditors or not. The responsible officers are guaranteed that no tax penalty will be assessed against them personally.

Note, *Bankruptcy Court Jurisdiction and the Power to Enjoin the IRS*, 70 Minn.L.Rev. 1279, 1299-300 (1986). Frequently, the efforts put forth by these officers during the reorganization is the corporation's only hope for future viability. In the absence of an express congressional statement that the Internal Revenue Code is to take priority over the Bankruptcy Code with regard to the allocation of tax payments, we decline to accept the argument of the IRS that all payments made under a Chapter 11 reoganization are involuntary and thus properly allocated by the IRS.

In weighing the competing public policy considerations of the Internal Revenue and Bankruptcy Codes, we are persuaded by the court's reasoning in *In re B & P Enter-*

prises, Inc., 67 B.R. 179, 183 (Bankr.W.D.Tenn.1986):[4] "the allocation question in a Chapter 11 case under the Bankruptcy Code should be left to judicial discretion to be decided on a case-by-case basis." In making this determination, the bankruptcy court is to consider the "equitable reasons warranting such allocations." Typically, the court should look to

> the history of the debtor, the absence or existence of prebankruptcy collection or "enforced collection measures" of the I.R.S. against the corporation and responsible corporate officers; the nature and contents of a Chapter 11 plan (e.g., last resort liquidation or reorganization); the presence, extent and nature of administrative and/or court action; the presence of pre- or post-bankruptcy agreements between the debtor (or trustee) and the I.R.S.; and the existence of exceptional or special circumstances or equitable reasons warranting such allocation.

Id. at 184. Most importantly, the bankruptcy judge should consider whether the proposed plan is merely a stop gap scheme to hold the taxing authority at bay with little chance that the debtor will fulfill its obligation under the plan. We recognize that the bankruptcy judge has previously considered and passed on the feasibility of the plan. In light of our pronouncement herein, we think it best to remand to the district court with directions that the bankruptcy court weigh the impact the proposed allocation would have upon the debtor, Internal Revenue Serv-

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[4] In *B & P Enterprises*, the court set forth a requirement that the debtor must demonstrate "exceptional or special circumstances" justifying the allocation. *Id.* at 184. The court proceeded to conclude that the debtor had not overcome this hurdle. We decline to adopt this "exceptional circumstances" test; rather, we hold that the determination of whether a debtor should be permitted to allocate taxes in a Chapter 11 reorganization is best left to the bankruptcy court upon consideration of the bankruptcy plan as a whole.

ice, and other creditors. Should the bankruptcy court conclude that the interests of all parties would be best served by allowing the debtor to allocate the payment of taxes, then that determination should stand in the absence of abuse of discretion. Accordingly, we REMAND to the district court for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

No. 86-3440
D.C. Docket No. 85-1552-13

IN THE MATTER OF A & B HEATING & AIR CONDITIONING, DEBTOR

UNITED STATES OF AMERICA, PLAINTIFF-APPELLANT

versus

A & B HEATING & AIR CONDITIONING, INC., DEFENDANT-APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA

Entered Aug. 4, 1987

JUDGMENT

Before: HILL and HATCHETT, Circuit Judges, and HENDERSON, Senior Circuit Judge.

This cause came on to be heard on the transcript of the record from the United States District Court for the Middle District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby, REMANDED; for further proceedings in accordance with the opinion of this Court;

It is further ordered that each party bear their own costs on appeal.

Entered: August 4, 1987
For the Court: Miguel J. Cortez, Clerk
By: /s/ David Maland
DAVID MALAND
Deputy Clerk

Issued as Mandate: Sept. 24, 1987

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 86-3440

IN THE MATTER OF A & B HEATING &
AIR CONDITIONING, DEBTOR

UNITED STATES OF AMERICA, PLAINTIFF-APPELLANT

versus

A & B HEATING & AIR CONDITIONING, INC.,
DEFENDANT-APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE MIDDLE DISTRICT OF FLORIDA

Sept. 10, 1987

ON PETITION(S) FOR REHEARING

Before: HILL and HATCHETT, Circuit Judges, and HENDERSON, Senior Circuit Judge.
PER CURIAM:

The petition(s) for rehearing filed by the appellant is denied.

Entered For The Court:
/s/ James C. Hill
JAMES C. HILL
United States Circuit Judge

APPENDIX D

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

Case No. 85-1552-Civ-T-13
Bankruptcy Case #84-424BK-T

IN RE:
A & B HEATING & AIR
CONDITIONING, INC., DEBTOR

A & B HEATING & AIR
CONDITIONING, INC., PLAINTIFF

VS.

UNITED STATES OF AMERICA, DEFENDANT

[Filed May 7, 1986]

ORDER

This is an appeal by the United States from the bankruptcy court's order on objection to the confirmation of the debtor's proposed first amended plan of reorganization entered in *In re A & B Heating and Air Conditioning, Inc.*, 53 B.R. 53 (Bankr. M.D. Fla. 1985) (C.J. Paskay, August 28, 1985). According to the United States (or "Internal Revenue Service" or "IRS"), the bankruptcy court abused its discretion by allowing a debtor, pursuant to a plan of reorganization in a Chapter 11 bankruptcy proceeding, to designate the application of payments to be made to the trust fund portion of the debtor's federal employment tax liability.[1] The United States argues that

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[1] 26 U.S.C. § 7501(a) provides for a special trust fund for an employer's withholding of employees' wage tax. The debtor's designa-

the debtor's payments on the tax liability are involuntary and therefore not subject to designation by the debtor.

It is undisputed that the taxpayer's right to direct the application of payments made to the Internal Revenue Service is dependent upon whether such payments are voluntary. *Muntwyler v. United States*, 703 F.2d 1030 (7th Cir. 1983). It the payment is involuntary the debtor has no right of designation and the IRS may allocate the payments as it sees fit. *Id.* at 1032 (citing Policy Statement P-5-60, *reprinted in Internal Revenue Manual* (CCH 1305-15). As the Seventh Circuit explained in *Muntwyler v. United States, supra*, "The distinction between a voluntary and involuntary payment . . . is not made on the basis of the presence of administrative action alone, but rather the presence of court action or administrative action resulting in an actual *seizure* of property or money as in a levy." 703 F.2d at 1033.

In the instant case, there was an actual seizure of the debtor's assets by the IRS approximately ten days before the debtor filed for Chapter 11 reorganization. Those assets, however, were returned to the debtor pursuant to an order of the bankruptcy court entered March 28, 1984. Therefore, the Internal Revenue Service's prior seizure is not dispositive on the issue of voluntariness.

The remaining issue is therefore whether the bankruptcy court's supervision over the debtor's Chapter 11 reorganization is of such a nature as to render payments stemming from the plan involuntary. Although there is some language in *Muntwyler v. United States*, 703 F.2d at 1033, which suggests that any bankruptcy proceeding is sufficient court action to render debtor payments involuntary, this Court believes that the better view is that pay-

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tion of its payments to that trust fund is apparently an attempt to avoid the liability imposed for failure to withhold employee wage taxes.

ments made by a debtor pursuant to Chapter 11 reorganization are voluntary. *See In re The Franklin Press, Inc.*, 52 B.R. 151 (Bankr.S.D. Fla. 1985) (distinguishing Chapter 11 liquidation cases cited by appellant as authority for involuntary payments from Chapter 11 reorganizations); *In re Hartley Plumbing Company, Inc.*, 52 B.R. 8 (Bankr. M.D. Ala. 1983). The debtor is thus entitled to designate its payments to the IRS.

The ruling of the bankruptcy court is AFFIRMED for the reasons expressed above.

DONE AND ORDERED in Chambers at Tampa, Florida, this 7th day of May, 1986.

/s/ George C. Carr
GEORGE C. CARR
United States District Judge

APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

Case No. 84-424 BK-T-11

IN RE: A & B HEATING &
AIR CONDITIONING, DEBTOR

[Filed Aug. 28, 1985]

ORDER ON OBJECTION TO THE CONFIRMATION OF THE DEBTOR'S PROPOSED FIRST AMENDED PLAN OF REORGANIZATION

THIS IS a Chapter 11 case and the matter under consideration is an Objection to the Confirmation of the Debtor's Proposed First Amended Plan of Reorganization filed by the United States of America. The Objection is based upon a number of grounds, however, the only issue to be addressed by this Order is whether the Internal Revenue Service (IRS) is bound by a provision in the Debtor's Plan which states that all payments to the IRS "shall be credited first to the trust fund portion of the claim until it is paid in full." The United States claims that all payments to the IRS under a confirmed Chapter 11 plan are involuntary payments and, therefore, that the IRS may apply such payments as it sees fit and that the Debtor is powerless to direct how payments are to be credited.

The law is clear that a taxpayer making voluntary payment to the IRS has the right to direct the application of those payments to whatever type of liability it chooses. *Muntwyler v. United States,* 703 F.2d 1030 (7th Cir. 1983); *O'Dell v. United States,* 326 F.2d 451 (10th Cir. 1964).

Conversely, when payment is involuntary, the IRS may allocate such payment as it sees fit. *United States v. DeBeradinis,* 395 F. Supp 944 (D. Conn. 1975), aff'd. 538 F.2d 315 (2d Cir. 1976); *Avildsen v. United (In re Avildsen Tools and Machines, Inc.*), 40 B.R. 253 (N.D. Ill. 1984). The definition of an involuntary payment can be found in *Amos v. Commissioner,* 47 T.C. 65 (1966) wherein the Court held that;

> "An involuntary payment of Federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefore."

Policy Statement P-5-60 reprinted in Internal Revenue Manual (CCH) 1350-15 states that "the taxpayer, of course has no right of designation in the case of collections resulting from enforced collection measures."

In the *Muntwyler supra* case the Court stated that a payment is involuntary only when made pursuant to judicial action or some form of administrative seizure, like a levy. *Muntwyler supra* p 1033. The Muntwyler case involved an individual who was the responsible officer of a corporation. When the corporation could no longer meet its obligations it made a common law assignment of all of its assets to a trustee for the benefit of its creditors. The IRS filed a claim with the trustee and sometime later received partial payment together with instructions on how the payment was to be applied. In *Muntwyler*, as in the present case, the parties sought to have payments applied to the trust-fund portion of the corporate tax liability so that the 100% penalty assessment against the responsible officer would be partially satisfied. The IRS in the *Muntwyler* case refused to follow the trustee's instructions and the responsible officer then paid the remainder of the 100% penalty. Subsequently, the responsible officer filed suit in

district court and sought a refund from the IRS. The Court stated that;

> "the distinction between voluntary and involuntary payment in *Amos* and all the other cases is not made on the basis of the presence of administrative action alone, but rather the presence of court action or administrative action resulting in an actual seizure of money or property as in a levy. No authorities support the proposition that a payment is involuntary whenever an agency takes even the slightest action to collect taxes, such as filing a claim or, as appears to be a logical extension of the Government's position, telephoning or writing the taxpayer to inform him of taxes due."

The payment was deemed to be voluntary and the trustee's designation of how payment was to be credited was upheld. The Government relies on a number of cases to support its position, however, each is distinguishable from the present case. The case of *In re Bulk Sale of Involuntary, Etc.*, 631 P.2d 258 (KAN. App 1981) involved a corporation which, pursuant to statute, turned over its assets to an auctioner for sale. After the assets were sold the proceeds were deposited by the auctioner into the Court registry and creditors were instructed to file claims for any amount due.

In *Bulk Sale* the placing of the assets in the auctioner's control and their eventual deposit with the Court effectively stripped the corporation of any control over its assets and more particularly of any control over how or when the IRS would be paid. The facts in *Bulk Sales* are more analogous to a seizure of property as in a levy than is a payment to creditors under a Chapter 11 plan.

The case of *In re Mister Marvins, Inc.*, 53 A.F.T.R. 2d 84-1065 (E.D. Mich. 1984) is also distinguishable. In *Mister Marvins* a trustee was appointed to replace a cor-

porate debtor in possession. The trustee liquidated the corporate assets and then entered in to an agreement with the Debtor and a creditor regarding distribution of the proceeds. The Bankruptcy Court approved the agreement and without notice to the Government also directed the IRS to apply payments received to the trust fund portion of the outstanding tax liability. The District Court, citing the *Muntwyler* case, reversed the Bankruptcy Court and held,

> "However, the distinction between a voluntary and involuntary payment in *Amos* and all other cases is not made on the basis of enforcement proceedings alone, but rather on the basis of the existence of non existence of some form of court action."

The Mister Marvins case is distinguishable in that the distribution was not made pursuant to a confirmed plan but rather pursuant to court order which authorized the settlement of a claim. The Court in the *Mister Marvins* case was clearly more active than is a court whose only concern is to determine if the proposed plan of reorganization meets the standards set forth in § 1129. In addition, *Mister Marvins* involved a liquidation of the debtor's assets by a trustee and a distribution outside of a confirmed plan. Clearly, Mister Marvins is distinguishable.

Lastly, the IRS relies on *Avildsen v. United States (In re Avildsen Tools and Machines, Inc.*, 40 B.R. 253 (D.N.D. Ill. 1984). In *Avildsen* the Bankruptcy Court entered an order authorizing the sale of the debtor's assets and directing the debtor to pay its outstanding liabilities with the sale proceeds. As specifically stated by the District Court, *Avildsen* involved "both judicial orders and a judicial sale." No such "judicial sale" is involved in the case sub judice.

This Court finds only one case which is factually similar to the present case, *In re Hartley Plumbing Company, Inc.*, 32 B.R. 8 (Bankr.M.D. Ala. 1983). In the *Hartley* case the court held that payments made to the IRS pursu-

ant to a confirmed Chapter 11 plan were voluntary. The court likened payments in a Chapter 11 case to those made pursuant to a Chapter 13 plan which payments are clearly voluntary. The court distinguished payments made by a Chapter 7 trustee which are clearly involuntary. See also, *Rollins v. McDanral, Chorey & Taylor (In re Melton)*, 39 B.R. 762 (Bankr, N.D. Ga. 1984)

Based upon the Muntwyler and Hartley cases and the authorities cited therein this court finds that the mere filing of a claim and confirmation of a plan in the context of a Chapter 11 reorganization case does not amount to court action resulting in actual seizure of money or property. Court involvement in the context of a Chapter 11 reorganization case is not the type which results in seizure of property or money as in a levy. Unlike a taxpayer faced with a government instituted collection proceeding which may lead ultimately to levy upon the taxpayer's assets, a Chapter 11 debtor enjoys great latitude in how and if a plan is proposed and thus how and when the IRS will be paid. § 1129 requires only that a plan provide for payment of pre-petition taxes over a period not to exceed 6 years from the date of assessment in order that it may be confirmed. The debtor propounding a plan has a number of options with respect to treatment of a claim by the IRS and it is the freedom afforded by these options which dictates the conclusion that payments to the IRS pursuant to a confirmed Chapter 11 plan of reorganization are voluntary. Accordingly, it is

ORDERED, ADJUDGED AND DECREED that the Objection to Confirmation of the United States of America be, and is hereby overruled. Upon the Debtor's Amendment of its First Amended Plan of Reorganization to provide for interest to the IRS at 12% per annum and specifying that the lien of the IRS shall be preserved, a hearing to consider confirmation will be set. The Debtor

shall have 10 days from the entry of this Order to file its Amendment to First Amended Plan of Reorganization.

DONE and ORDERED at Tampa, Florida on August 28, 1985.

/s/ Alexander L. Paskay
ALEXANDER L. PASKAY
Chief Bankruptcy Judge

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87-1243

No. 87-1234

Supreme Court, U.S.
FILED
APR 12 1988
JOSEPH F. SPANIOL, JR.
CLERK

In The

Supreme Court of the United States

October Term, 1987

UNITED STATES OF AMERICA

Petitioner,

vs.

A & B HEATING AND AIR CONDITIONING, INC.

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF RESPONDENT IN RESPONSE TO PETITION OF THE UNITED STATES OF AMERICA FOR WRIT OF CERTIORARI

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11 U.S.C. (& Supp. IV) §1129 1
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STATUTES INVOLVED

In addition to the statutes set forth in the Petition for Writ of Certiorari filed by the United States of America, Section 1129 of the Bankruptcy Code, 11 U.S.C. (& Supp. IV) 1129, provides in pertinent part:

Confirmation of Plan

(a) The Court shall confirm a Plan only if all of the following requirements are met:

. . .

(11) Confirmation of the Plan is not likely to be followed by the liquidation or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

SUMMARY OF ARGUMENT

Payments made pursuant to a confirmed Chapter 11 plan are voluntary payments such that the application of the payments may be designated by the taxpayer. Payments made pursuant to a confirmed Chapter 11 plan are not compelled or coerced by the Bankruptcy Court, which serves only to ensure that the statutory requirements for confirmation set forth in 11 U.S.C. §1129 are met. If the concern of the Petitioner is that a default in making payments pursuant to the Chapter 11 plan could in some fashion jeopardize the public fisc then the proper objection to have raised to confirmation of the Chapter 11 plan was one based on

11 U.S.C. §1129 (a)(11) asserting an insufficient showing of feasibility, and demonstrating a potential for further reorganization or liquidation.

Moreover, the ability to designate the application of tax payments is of great importance in the case of a closely-held corporate debtor. The Respondent, as with many closely held corporations, depends on the continued, complete attention of the officer or other person against whom liability is asssessed pursuant to 26 U.S.C. §6672 for its continued ability to be a productive business generating sufficient income to fund any payments pursuant to a Chapter 11 plan.

REASON FOR DENYING THE PETITION

The question of whether tax payments made pursuant to a confirmed Chapter 11 plan are voluntary such that the application of the payment can be designated by the taxpayer is now moot in this case. Arthur Clement, Jr., the sole officer, director and shareholder of the Respondent has paid in full, without deduction or credit for any payments made by Respondent pursuant to its confirmed Chapter 11 plan, all liability assessed against him pursuant to 26 U.S.C. §6672. Therefore, all payments received by Petitioner pursuant to the Chapter 11 plan can now be applied without regard to the designation set forth in Respondent's plan.

CONCLUSION

The petition for a writ of certiorari should be denied, as moot.

Respectfully submitted,

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April 1988

Supreme Court, U.S.
FILED
MAY 10 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1243

In the Supreme Court of the United States

OCTOBER TERM, 1987

UNITED STATES OF AMERICA, PETITIONER

v.

A & B HEATING AND AIR CONDITIONING, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY MEMORANDUM FOR THE UNITED STATES

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY MEMORANDUM FOR THE UNITED STATES

Respondent contends in its brief in opposition that the petition for a writ of certiorari should be denied on grounds of mootness because the outstanding withholding tax liability has been paid by the corporation's responsible person (see 26 U.S.C. 6672). This contention is erroneous in two respects. First, the suggestion of mootness is incorrect. Second, and more important, when and if the case becomes moot, it would not be appropriate for this Court to deny the petition. Rather, the correct course of action would be to grant the petition, vacate the judgment of the court of appeals, and remand with a direction to dismiss the case as moot. See *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39-40 (1950).

1. As explained in our petition, we sought certiorari in this case in order to resolve a conflict in the circuits on an important and frequently recurring issue of federal law. The court below upheld the power of a bankruptcy court to allow a corporate debtor's Chapter 11 reorganization

plan to contain a provision designating priority federal tax payments under the plan for application first to trust fund tax liability. That would have the effect of reducing pro tanto the separate liability of respondent's responsible officers for the trust fund taxes (see 26 U.S.C. 6672). As a result, tax payments under the Chapter 11 plan would first redound to the benefit of the corporate officers, not the government, and, if the plan failed after a few payments, the government would be left with uncollectible non-trust-fund tax liabilities. In the absence of such a provision, the government would have a greater opportunity to make itself whole because it could apply the corporate Chapter 11 plan payments first to the corporation's non-trust-fund tax liabilities and then, if the plan failed, seek to recover the trust fund taxes from the responsible corporate officers.

The decision below is the only court of appeals decision to uphold the validity of such a designation provision in a Chapter 11 plan. We sought certiorari to resolve a conflict with the Third and Ninth Circuits, which have held that such a designation is invalid because a taxpayer is not entitled to designate the application of involuntary payments of tax liabilities, such as those made pursuant to court order. See *In re Technical Knockout Graphics, Inc.*, 833 F.2d 797 (9th Cir. 1987); *In re Ribs-R-Us, Inc.*, 828 F.2d 199 (3d Cir. 1987).

2. Subsequent to the filing of the government's petition, steps have been taken to moot the case. On February 1, 1988, Arthur Clement, respondent's responsible officer who is liable under Section 6672 for the corporation's delinquent trust fund taxes and who is represented by the same counsel as respondent, obtained a bankruptcy court order in his personal bankruptcy proceedings that authorized the sale of his personal residence and the payment in full of all liens thereon. *In re Clement*, No.

86-4811-BKC-8P1 (Bankr. M.D. Fla.). One of those liens was a federal tax lien securing his Section 6672 liability. The property has now been sold, and Clement has satisfied his Section 6672 liability, thereby releasing the tax lien.

Respondent suggests that this development moots the case, stating that, in light of the responsible officer's satisfaction of the tax liability, "all payments received by Petitioner pursuant to the Chapter 11 plan can now be applied without regard to the designation set forth in Respondent's plan" (Br. in Opp. 2). It is highly questionable, however, whether the government is entitled to ignore the designation provision in the Chapter 11 plan. A responsible person has two years to seek a refund of a payment he has made (26 U.S.C. 6511(a)). See *USLIFE Title Ins. Co.* v. *Harbison*, 784 F.2d 1238, 1243 n.6 (5th Cir. 1986). Until the final adjudication of such a refund suit or until the time for filing a refund suit expires, it is not certain that the government will be entitled to retain the payment. See *id.* at 1244; *Gens* v. *United States*, 615 F.2d 1335, 1340 (Ct. Cl. 1980). Accordingly, the Internal Revenue Manual provides that an assessment against the corporation for trust fund taxes will not be abated upon the satisfaction of the liability by a corporate officer; rather, the assessment is not abated until the expiration of the statutory period for bringing a refund claim. See [2 Admin.] Internal Revenue Manual (CCH) 5638.1(b), at 6821 (May 1987). Because the trust fund tax assessment against the corporation has not been abated, the government arguably remains bound by the designation provision of the Chapter 11 plan to apply tax payments first to satisfy that assessment. And Clement, the responsible officer, will retain for two years his right to seek a refund of the amount he paid; indeed, application of the Chapter 11

payments to reduce the corporation's trust fund tax liability would provide Clement with a basis for obtaining a refund.

This case therefore is not moot at this time. It is within respondent's power to moot the case, however, by withdrawing the designation provision, with prejudice, from its reorganization plan. It is not apparent why respondent should be unwilling to take this action; its representation in the brief in opposition (at 2) that it does not regard the government as bound to abide by the designation indicates that respondent does not intend to rely upon it. Thus, in light of the steps that Clement, represented by respondent's counsel, has taken toward mooting the case and in light of respondent's suggestion in its brief in opposition that it views the designation provision as a dead letter, there is no assurance that respondent would permit this case to be decided when it has the power to moot the case at any time by withdrawing the designation provision. At the present time, however, there persists a conflict in the circuits warranting this Court's review.

3. In any event, respondent errs in suggesting that a petition for certiorari should be denied if it becomes moot. The "established practice" when a civil case meriting review has become moot while on its way to this Court is to vacate the judgment below and to remand with instructions to dismiss the case as moot. *United States* v. *Munsingwear*, 340 U.S. at 39-40. See also, *e.g.*, *Burke* v. *Barnes*, No. 85-781 (Jan. 14, 1987); *State Fair* v. *United States Consumer Product Safety Commission*, 454 U.S. 1026 (1981). As the Court explained in *Munsingwear*, this practice "eliminates a judgment, review of which was prevented through happenstance. When that procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary" (340 U.S. at 40). Thus, if mootness

prevents this Court from resolving the conflict in the circuits occasioned by the decision below, the Court should vacate the judgment below and remand the case for appropriate action.

At this time, there is considerable uncertainty about when and if this case will become technically moot because of the apparent inconsistency between the retention of the designation provision in respondent's Chapter 11 plan and respondent's suggestion in this Court that it no longer intends to rely on that provision. That uncertainty can be definitively resolved by action taken in the bankruptcy court. Accordingly, the Court may wish to consider vacating the judgment below and remanding the case to the court of appeals with instructions to direct the bankruptcy court to remove the designation provision from the plan in light of respondent's representation to this Court that payments under the plan "can now be applied without regard to the designation" (Br. in Opp. 2).

Respectfully submitted.

CHARLES FRIED
Solicitor General

MAY 1988

☆ U.S. GOVERNMENT PRINTING OFFICE: 1988—202-037/60437